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No. 99-756

Supreme Court, U.S.
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In The

Supreme Court of the United States

JEFFREY H. MIMS, Trustee of the Estate of Coastal Plains, Inc., and INDUSTRIAL CLEARINGHOUSE, INC.,

Petitioners,

v.

BROWNING MANUFACTURING, A Division of Emerson Power Transmission Corporation; and Formerly a Division of Emerson Electric Co.,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

PETITIONERS' REPLY TO BRIEF IN OPPOSITION

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PETITIONERS' REPLY TO BRIEF IN OPPOSITION

In its Opposition, Browning unfortunately has chosen to use its "statement of facts" as a weapon to attempt to cloud the issues for review. Undoubtedly, this case has been hotly contested at every level, and certainly the parties dispute many facts. But the factual disputes were resolved against Browning by the bankruptcy court, the trial court, and the jury (and not challenged on appeal), and should not distract this Court from the important questions about judicial estoppel and bankruptcy law presented by this case.[1]

REPLY TO BROWNING'S REASONS FOR DENYING THE WRIT

When one looks beyond Browning's statement of facts to its asserted legal justifications for this Court to deny the Petition, it becomes evident that each falls flat. Browning presents four basic arguments why this Court should deny this Petition. None is telling.

I. Contrary to Browning's contention, this case creates a deep and well-developed split in the Circuit Courts of Appeals on an important issue of federal law, viz., *whether and to what extent the doctrine of judicial estoppel applies in federal cases, and bankruptcy cases in particular.* Petitioners are not the first to notice the deep division over this issue; courts and respected commentators alike have taken notice and commented upon the split. *See, e.g., Cleveland v. Policy Management Systems Corp.*, 119 S.Ct. 1597, 1601 (1999) (listing different judicial estoppel rulings by the Circuits on the same question) (Pet. 13 n.5). The authors of Moore's

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[1] All facts material to this case were presented by the trustee and Industrial in their petition. *See* Pet. 5-10. Lest silence in the face of Browning's unfounded accusations be taken for acquiescence, however, petitioners have reluctantly included a short response to Browning's attacks at the conclusion of this brief, *see infra* at 8-10. It explains why both judges and jurors have found that Browning, not Coastal or Industrial, committed misconduct in this case, why that misconduct caused Coastal's demise, and why that misconduct warranted a multi-million dollar sanction.

federal practice have observed that there are uniformity problems in the federal law of judicial estoppel resulting "from the lack of guidance from the Supreme Court." 18 *Moore's Federal Practice* §§ 134.30 *et seq.* (Matthew Bender 3d ed. 1999). Browning attempts to obscure the well-known split on this issue, which is fairly presented by the facts of this case, by essentially re-writing the questions presented by the petitioners, narrowing them almost to the point of absurdity before reaching the conclusion that the courts are in agreement. *See* Opp. 15 (phrasing issue as whether judicial estoppel "appl[ies] to the failure to disclose claims in bankruptcy schedules and stipulations," rather than whether judicial estoppel is recognized by federal law generally, or in the bankruptcy context in particular). But the simple fact remains that whereas two Circuits have rejected judicial estoppel in its entirety in federal law cases, properly criticizing the doctrine as an outmoded impediment to the search for truth, Pet. 11, 15, the Fifth Circuit applied judicial estoppel forcefully in this case. The Court need not and should not wait for a Circuit to reject judicial estoppel in the specific context of a failure to disclose in a bankruptcy case involving undisclosed claims in bankruptcy schedules prior to addressing this issue.[2]

The fundamental disagreement over the existence of federal judicial estoppel alone would merit review by this Court, but the divisions in the lower courts run still deeper. The Fifth Circuit applied an extreme form of judicial estoppel that included a rule of "inferred intent," which requires application of judicial estoppel in bankruptcy nondisclosure cases *even if contrary to* the facts as established by a bankruptcy court's findings and a jury's verdict. The Fifth Circuit's ruling thus creates fundamental and outcome-determinative conflicts with other Circuits in bankruptcy cases, even among those Circuits recognizing the doctrine. Pet. 18-19, 20-26.

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[2] Such a case would never arise in a Circuit that has rejected the doctrine outright; it follows *a fortiori* that a circuit that does not recognize the doctrine at all does not follow the doctrine in that particular instance.

Although the Third Circuit applies judicial estoppel in federal cases generally, in *Ryan Operations, G.P. v. Santiam-Midwest Lumber Co.*, 81 F.3d 355 (3d Cir. 1996), that court reversed the district court's application of judicial estoppel in a bankruptcy case, expressly *rejecting* the defendant's argument that courts should apply a doctrine of "inferred intent" to satisfy the requirement that a debtor must have failed to disclose a claim *intending* to deceive. The Third Circuit held that the determination of a debtor's intent should be left to the factfinding capabilities of the bankruptcy court.[3] In conflict, the Fifth Circuit overrode the bankruptcy court's factual findings that Coastal had no intent to deceive by declaring that factor not relevant and applying instead a rule of inferred intent. This conflict merits resolution by this Court.

Browning attempts to sidestep the Circuit conflict over whether a defendant's reliance on a debtor's nondisclosure is an essential element of judicial estoppel, Pet. 24, by asserting that "the Fifth Circuit expressly found that Browning had detrimentally relied." Op. 17. The Fifth Circuit did not make any such express finding. Rather, the Fifth Circuit went no further than to state in a footnote that "there is evidence" of reliance. Pet. App. 23 n.8. The bankruptcy court, which did make "findings," found that Browning "knew all along that damages were being sought against it," and that Browning was not "misled by failure to list the lawsuit in the Schedules, nor by the Stipulation, or order on the motion to lift stay . . . " (Pet. App. 64-65).

If left standing by this Court, the opinion below will upset uniform and effective application of Chapter 7 and thwart the intent of Congress in enacting that chapter of the Bankruptcy Code. The Fifth Circuit's decision *extinguishes* unscheduled claims belonging to the debtor's estate, even in the hands of the trustee and after a jury has found the claims

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[3] *Ryan* also rejected the proposition advanced by Browning (Opp. 21) that omitted claims are routinely judicially estopped. There, the Third Circuit reviewed many of the same cases cited in the Opposition and declared that it was "not persuaded by their analysis." 81 F.3d at 364.

valuable and meritorious. Yet, § 704(4) of the Code requires trustees to search for and liquidate claims that were *not* scheduled by debtors. Pet. 27. By exalting the Bankruptcy Code's requirement for debtors to schedule claims above all else, the Fifth Circuit has rendered Code section 704(4) nonsensical, converting it into a requirement that trustees engage in a meaningless search.

II. Browning's claim that the questions presented in the Petition were not fairly preserved in the courts below is specious. Browning overlooks the fact that the petitioners were the *appellees* in the Fifth Circuit, and it was Browning, not the petitioners, who urged the Circuit to apply judicial estoppel after both the bankruptcy and district courts refused to do so. As appellees, petitioners were under no duty to list every possible rationale in support of the decision below in order to preserve that argument for appeal in the event of an adverse ruling.[4] The issue Browning presented to the Fifth Circuit was broadly stated: "Whether Plaintiffs' claims are barred by the doctrine of judicial estoppel,"[5] and the petitioners' broad response in the lower courts was that the claims were not so barred. "Once a federal claim is properly presented, a party can present any argument in support of that claim; parties are not limited to the precise arguments they made below." *Lebron v. Nat'l R.R. Passenger Corp.*, 513 U.S. 374, 379 (1995) (*quoting Yee v. Escondido,* 503 U.S. 519, 534 (1992)).

Petitioners consistently have maintained at every necessary point in this litigation that they should not be judicially estopped from asserting or recovering on the claims against Browning found meritorious by the jury. Indeed, after the Fifth Circuit's reversal of the lower courts by applying judicial estoppel as a matter of law, petitioners sought panel and *en banc* rehearing, arguing that that the Tenth and D.C.

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[4] Petitioners briefed numerous defenses in the Fifth Circuit, including that the bankruptcy court did not abuse its discretion by refusing to apply judicial estoppel.

[5] Appellant Browning's Brief in the Fifth Circuit at 23.

Circuits reject judicial estoppel altogether and describing the conflicts between the Fifth Circuit's rule of "inferred intent" and the rules in other Circuits.[6] These issues are properly presented here. *Lebron*, 513 U.S. at 379; *Virginia Bancshares, Inc. v. Sandberg*, 501 U.S. 1083, 1099 n.8 (1991).

Browning's argument that petitioners waived the right to rely on Bankruptcy Code § 554 in support of their claim misstates the point. Opp. 13. The Code deals with the matter of unscheduled assets in the estate of the debtor, and takes those assets from the debtor and *preserves* them in the hands of the trustee for the benefit of creditors. Contrary to the Fifth Circuit's view, the Code does not need to be patched, amended, or overlaid with the common law doctrine of judicial estoppel; and the Fifth Circuit's apprehension that Chapter 7 debtors may "emerge" from bankruptcy to profit from undisclosed claims was erroneous and misplaced.

Browning's contention that petitioners "waived" the point that judicial estoppel should not be applied to the trustee is also without merit. Opp. 13. Petitioners contended in each of the three courts below that judicial estoppel should not be applied to *either* the trustee or Industrial. The bankruptcy court concluded that Coastal's tort causes of action had always remained the property of the trustee (Pet. App. 8, 63), and were not subject to Browning's claim of judicial estoppel (Pet. App. 70). Although Browning ultimately succeeded on appeal in convincing the Fifth Circuit to ignore the corporate distinctions between the debtor (Coastal) and Industrial, none of Browning's arguments applied to either the trustee's or Coastal's *tort* causes of action. When the Fifth Circuit overlooked these distinctions, both well-developed in the record below, petitioners focused on the distinctions in their motions for rehearing.[7]

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[6] *See* the Trustee's and Industrial's Petition for Rehearing En Banc 6-7, 11-12 (filed July 14, 1999) and Petition for Panel Rehearing 6-7 (filed July 9, 1999).

[7] *See* Petition for Rehearing En Banc 7-11; Petition for Panel Rehearing 1-5. Browning's citation to *Moore v. El Paso County, Texas*, 660

III. No disputed or unique facts make this case unsuitable for Supreme Court review. Indeed, the opposite is true. The case comes to this Court after a bankruptcy court has entered findings of fact pertaining to judicial estoppel. Browning contested *none* of those findings of fact on appeal as clearly erroneous.[8] The case also comes here after a jury has decided all disputed facts about whether Browning breached contracts and committed torts against Coastal and whether Browning's actions caused damages to Coastal. The district judge who presided over the jury trial denied all of Browning's motions challenging the jury's findings for insufficient evidence. Browning correctly concedes that the Fifth Circuit applied judicial estoppel in this case *as a matter of law*. Opp. 12. All the facts in this case have been adjudicated, but the Court of Appeals overrode them with the inferred intent doctrine. Absent review by this Court, bankruptcy cases in the Fifth Circuit – but not in other Circuits – will be governed by the Fifth Circuit's policy choices rather than the factual findings of the lower courts. This conflict and the consequent damage to the public interest in uniform implementation of the Bankruptcy Code warrant granting the Petition.

IV. Causation poses no obstacle to the resolution of this case, and was correctly resolved by the lower courts in any event. Browning spent much time before the district court jury arguing that there was no causal link between its breaches of contracts with Coastal and its torts against Coastal and Coastal's demise. After the jury decided that question of fact

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F.2d 586, 590 n.4 (5th Cir. 1981), is inapposite. *Moore* held only that the defense of limitations, not pleaded as an affirmative defense in the trial court, was waived. *Id.* Although Fifth Circuit jurisprudence generally prohibits the addition of issues on appeal for the first time on rehearing, that did not happen here. The trustee's position in the Fifth Circuit consistently was that the lower courts properly refused to apply judicial estoppel against him.

[8] Appellant Browning's Brief in the Fifth Circuit at 32 n.11.

against Browning, Browning moved the district court, unsuccessfully, to grant judgment or a new trial on causation;[9] then Browning argued lack of causation, based on Texas law, in the Fifth Circuit. Much of the Opposition argues the same point. Browning's argument, simply put, is that Coastal was already a sick company, and that Browning should not be held liable for maliciously taking actions against Coastal.

The causation point was not passed on by the Fifth Circuit and poses no obstacle to review of the questions presented in the Petition. Indeed, it is not unusual for this Court to remand cases to the lower courts to address other issues after it decides important questions of federal law. *See, e.g., United States v. Beggerly,* 524 U.S. 38, 49 (1998). In any event, substantial evidence supports the jury's finding of causation. *See infra* at 7-8.

REPLY TO BROWNING'S STATEMENT OF FACTS

Browning's 10-page "Statement of Facts" ignores the fact that the bankruptcy judge and the jury – both of whom heard all the evidence – decided nearly every question of fact against Browning. Petitioners will briefly comment on three issues in the Opposition that are most in need of correction.

I. Misconduct by Browning was the cause of Coastal's demise. When the Texas economy and the oil industry turned down Coastal experienced serious cash flow problems. In a 1985 letter that Browning colorfully (but grossly inaccurately) portrays as a "ransom demand," Opp. 4, Browning, with the consent of Westinghouse (its secured creditor) proposed to its creditors a "new business plan" whereby Coastal's inventory (most of which had been paid for by Coastal with its own cash or loans from Westinghouse) would be purchased back by Coastal's suppliers for cash and account credits, and Coastal would thereafter hold the inventory for sale on consignment. The plan also proposed that Coastal would execute promissory notes for amounts owed on account to its creditors and pay those notes over 36 months (Def. Exh.

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[9] Order, September 16, 1997, 18-V4:677.

26, 27). An alternative to the plan was a Chapter 11 filing. Westinghouse, Coastal's secured creditor, held a security interest in all inventory in Coastal's possession.

Browning, *Coastal's primary supplier*, agreed to Coastal's plan, but insisted that Coastal physically return all of the Browning products in Coastal's inventory to Browning's warehouses. Browning promised promptly to return that inventory to Coastal pursuant to a consignment agreement. Browning obtained possession of Coastal's inventory, but then breached its agreements by refusing to pay for or return the inventory. Without Browning products, Coastal could not fill customer orders for industrial parts. The inventory in effect served as Coastal's blood supply. After Coastal remained without goods to sell for some time, "Coastal's phones just stopped ringing." 18-V54:162-63. Coastal was bled dry.[10]

Although Coastal had been told by a dismayed Browning employee in early 1986 that Browning was formulating a plan neither to return Coastal's inventory nor pay for it, 18-V53:4: confirmation of the maliciousness of Browning's plan was found only by later discovery of internal Browning documents. Browning's documents recorded a plan to hold on to Coastal's inventory, force Coastal into bankruptcy, and then purchase the inventory at a depressed price of 30 cents on the dollar Pl. Ex. 38. Consistent with this scheme, Browning commenced selling its products in Coastal's territory through other distributors. One of those distributors testified that, in effect, Browning offered him "Coastal's head on a platter." 18-V60:24.

II. Coastal never concealed any claims from the respondent. It is undisputed that (1) Coastal pleaded its claims in an

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[10] Browning's credit manager admitted at trial that Coastal would have remained viable had Browning carried out its agreements with Coastal. 18-V56:27. Browning's president testified that Coastal probably would have survived. 18-V56:152. Finally, Coastal's fact and expert witnesses detailed for the jury the plans for saving Coastal and how those plans would have worked but for Browning's actions. *E.g.*, 18-V53:50-51; 18-V56:53-69.

adversary complaint filed and served almost immediately after Coastal filed its Chapter 11 petition (Pet. App. 5, 43), and (2) the bankruptcy court found, after an evidentiary hearing (in findings of fact never challenged as clearly erroneous) that Browning, Westinghouse and the trustee were aware of Coastal's claims at all material times, and that Coastal, its officers and attorneys, had not engaged in any fraud on the court (Pet. App. 64-65, 68, 80). Coastal's adversary proceeding against Browning was discussed at a meeting of Coastal's creditors and was common knowledge. 18-V9(BK):163; 18-V10(BK):56, 228-30).

Browning seeks to detract from the Petition by pointing to the undisputed fact, *see* Pet. at 7, that Industrial was formed by Mr. Duke, former CEO of the now-defunct Coastal. Browning overlooks the fact that Industrial purchased Coastal's assets from *Westinghouse*, a third-party unsecured creditor, for $1.24 million. Pet. App. 7. The bankruptcy court found that Westinghouse always knew of Coastal's claims against Browning. Pet. App. 64, 65. Westinghouse had no incentive other than to sell Coastal's assets for the highest price available.

III. The trustee's sharing agreement is fair, and irrelevant to the legal issue on appeal. Browning unsuccessfully tried to attack the trustee's sharing agreement before the bankruptcy court, the district court, and the Fifth Circuit in a prior appeal, but each of those courts approved the trustee's agreement. Pet. App. 8-9. Browning tries again here by pretending that no trustee for the estate is present. But the trustee is present and is representing the interest of the estate, including all creditors. 11 U.S.C. § 323. The trustee agreed to the sharing mechanism with Industrial based on proper consideration, *i.e.*, Industrial's agreement to relieve the trustee of any obligation to fund the litigation or pay attorneys fees.[11] The trustee and Coastal's creditors would certainly prefer to have

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[11] Without this agreement the estate could not have proceeded with the adversary case; the estate had been closed and its assets distributed. *See* Pet. App. 54.

15% of the judgment reversed by the Fifth Circuit (which would have entitled them to approximately $750,000) over an empty pocket.

In any event, Browning's factual argument does not dispense with the need for review because the Fifth Circuit's decision is one of general applicability, and will bar claims against inadvertently unscheduled assets even where 100% of the recovery would go to creditors.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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